

Chapter 1

Introduction

The aim of this book is to bring together key papers on the impact of liberalisation on the economies of both developed and developing countries. Many have appeared in journals and other collections, but by grouping the essays together important insights emerge that are not evident in each of the individual contributions. In the various studies we examine the impact of liberalisation on the structure of both the micro- and the macroeconomy. Liberalisation may impact on research and development at a firm level; it may increase the profitability of enterprises; it may lead to an increase in exports in the long run and it may increase foreign direct and indirect investment and impact on economic growth. Some of these impacts may or may not be realised at a country level and hence a study at the country, region and world level becomes imperative. Theoretically, there are differing opinions on the effects of liberalisation. Some economists strongly believe that free trade promotes economic growth, while others hold that free trade may be harmful to economic growth as increased imports could destroy domestic industries. The use of the terms liberalisation and globalisation is very common in the literature and also in day-to-day conversations. It is important therefore to distinguish between liberalisation and globalisation.

Globalisation and Liberalisation

Globalisation is not just a single phenomenon. It encompasses a range of trends and forces leading to openness, integration and the interdependence of economies. The integration of economies on a worldwide basis considers

the world as a single market, and production area is simply a subset of regional economies rather than national economies linked by trade and investment flows. Global resources may be used optimally, including the competitive sourcing of inputs to achieve cost competitiveness in production, economies of scale and efficient technology utilisation. Globalisation will lead to easy movement of product and factor flows across borders where trade, services, investment, financial capital, technology and labour freely move. At a firm level, globalisation can lead to a process where firms coordinate their activities across national boundaries with a view to maximising profits and remaining competitive.

Globalisation has both positive and negative aspects. On the positive side, globalisation can provide operational economies of scale, technological and productivity improvements through cross-border specialisation and the utilisation of global factors of production and technology. It may also provide the productive application of capital worldwide, maximising rates of return on savings and investment where national opportunities are limited. On the negative side, there may be a loss of employment where labour intensive production in low-income countries is prevalent. National policies are sacrificed in favour of globalisation, and multilateral global rules might result in a loss of sovereignty.

Trade liberalisation embraces all the elements in the opening of markets and can have one or several of these ingredients. There may be a reduction in tariffs and non-tariff barriers, a relaxation of investment and capital flows between countries and an enhanced transparency of trade policies and trade facilitation measures. Trade liberalisation in a broad sense argues for measures that facilitate an increase in trade and does not necessarily imply free movement of factors of production such as labour and capital. Trade liberalisation means reducing the limits on trade that countries around the world have erected over a number of years. Protectionism aims to ensure that domestic industries are protected from competition from foreign producers and can be implemented through tariffs, quotas and other non-tariff barriers such as regulations and legislation that make hard for foreign competitors to sell goods into another country.

Financial liberalisation refers to market opening measures that can deal with the free movement of financial capital from one country to another. Some deregulatory measures combined with investment opportunities to foreign firms and tax relief to flow of financial capital from foreigners to

domestic economy would lead to a liberalisation of finance. In the extreme situation where all controls are removed on foreign private investment, capital will move freely across national borders.

Pro-Liberalisation and Its Opponents

The pro-liberalisation lobby has two strong proponents (Bhagwati, 2004; Wolf, 2004; Bhagwati and Kreuger, 1974) who strongly argue that globalisation and outward-oriented policies contribute to sustained economic growth. Panagariya (2004) has found that the growth miracle countries that grew at a rate of 3 percent per capita or more on a sustained basis between 1961 and 1999 almost always experienced a rapid growth in trade. Moreover, there are few examples of highly-protected countries that managed to grow rapidly on a sustained basis without lowering their level of protection. Countries that have failed to grow had a dismal trade performance. Some serious advocates of free trade argue that openness is by itself sufficient for growth. They are aware that macroeconomic stability, the enforcement of contracts and policy credibility are necessary to register significantly higher economic growth. However, such policies yield better prospects for growth under an open trading environment. Openness serves as a direct stimulus to growth. Even if we ignore the initial stimulus to economic growth, it can be stated that increased growth often leads to increased trade liberalisation and vice versa.

Among the free trade sceptics, Rodriguez and Rodrik (1999) provide a critique of the link between growth and openness. Cross-country regression studies provide weak evidence on the relationship between openness and growth. The South Centre of the United Nations raises severe doubts about the benefits of liberalisation and globalisation and remains critical of the World Bank studies, which according to the Centre are based on a misinterpretation of the facts. Liberalisation and globalisation have progressed at a slower pace in developing countries as compared with advanced countries. However, the pace of liberalisation quickened in the 1980s in many developing countries under the structural adjustment programme of multilateral financial institutions. Liberalisation of capital flows in developing countries has proceeded further than trade policy reform largely to attract foreign direct investment and non-debt-creating equity flows.

Wacziarg and Welch (2003) have constructed a panel data set on income growth and liberalisation, which allowed them to identify both within country and between country variations. They find that, on average, a country grows at a set 1.5 percent per annum higher rate in the liberalised phase than in the protected phase, controlling for country and year effects on the panel data. While assessing the impact of openness on growth, real exchange rate policy is very important. If the real exchange rate is left overvalued when countries liberalize, it maintains the discrimination against traded goods. This would obviously reduce the impact of openness on growth. Stiglitz (2002) raises issues about the speed of liberalisation. His argument rests on two main considerations, namely, that trade liberalisation must be gradual and developed countries need to do their part by removing trade barriers on products of interest to developing countries, especially agriculture, where domestic and export subsidies further harm the interests of developing countries.

Some of the sceptics of free trade do not recommend protectionism, and it seems that on the whole they are not against free trade and liberalisation. The financial crises in Latin American economies and East Asian economies gave perhaps a bad name to trade liberalisation. The collapse of growth in Latin American economies in the 1980s might not be entirely due to financial problems. International financial institutions such as the World Bank and orthodox economists attribute this failure to the insufficient integration of Latin American countries with the international economies and the relatively larger role of the state in these economies. Others argue that Latin America's poor performance is perhaps due to its debt crisis, and this could be also due to changes in the world economy and to external forces over which Latin American economies have no control (United Nations, 2003).

The South Centre and UNCTAD conclude that for developing countries, the first best policy with respect to liberalisation and globalisation is not to seek rapid and close integration but rather to define careful policies of selective integration, which is called strategic integration. If the first best policies are not feasible, then UNCTAD would need to spell out other alternatives for developing countries. During the 1980s and 1990s, many developing countries went for far-reaching market-oriented reforms with the expectation that improved factor allocation would turn out to be an important ingredient in their integration in a globalising economy. However,

the reforms were met with low rates of investment and deindustrialisation. The fast pace of trade liberalisation created trade deficits, which added to payment difficulties and increased dependence on capital flows. Capital inflows involved raising interest rates, which hindered domestic investment and slowed growth and currency appreciation, which reduced the international competitiveness of domestic producers and adversely affected trade performance (UNCTAD, 2006).

Chile opened up its economy to trade by reducing tariffs and undertook reforms such as privatisation. Macroeconomic affairs were well managed, and unlike other Latin American economies, macroeconomic stability was maintained. Chile is the only major economy that has maintained a sustained rapid growth in Latin America. In 1981–1991 and 1991–2001, its GDP grew at an annual rate of 5.3 and 5.9 percent, respectively. The experience of China and India during the 1980s and 1990s suggests that outward oriented policies are necessary to achieve higher growth performance. Starting from the 1970s, China began to open its economy to both trade and foreign investment side by side with other policy measures. China's GDP grew at near double-digit rates during both the 1980s and the 1990s with per capita incomes quadrupling over the two decades. Both exports and imports grew at phenomenal rates, and this implies that trade was the engine of economic growth in China.

The economic transitions of Russia and East Germany in Europe, Botswana and Mauritius in Africa and Chile in Latin America strongly suggest that globalisation is a two-edged sword. If a country maintains economic policies that are complementary to the prevailing conditions of the global economy, it is likely to benefit in terms of economic growth. To some extent, the tendency to cast blame on globalisation for domestic economic failures is misplaced. For the longer term, the analysis points to the conclusion that every country must globalize its economy in order to attain high and sustained GDP growth rates (Letiche, 2006). However, the analysis and experience also indicates the need for a greater stabilization of the global economy, and this can be facilitated not only by fundamental reforms of existing international economic institutions, but also by reductions in the developed world of agricultural subsidies and tariffs on imports from the developing nations. The *New Growth Centres* to which Klein (2004) refers to are Russia, India and China, for which he predicts

sustainable growth rates. China has grown at a rate of seven to 10 percent annually from 1978 except for the short period 1989–1990. The Indian economy strives to achieve seven percent and hopes to be able to maintain such a rate of growth, while the Russian growth rate will not be as high as that of India and China but will be encouraged by the demonstration effect.

Gains from Trade^a

Thirlwall (2000) raises doubts about the gains from trade being equitably distributed. Trade is an important engine of economic growth, and there could be both static and dynamic gains from it. In his view, most developing countries are constrained in their growth performance by a shortage of foreign exchange and could grow faster with more exports. Dynamic gains from trade are due to shifts in the production possibility frontier as trade is related to more investment, faster productivity growth with scale economies, learning by doing and the acquisition of new technologies from abroad, especially through foreign direct investment. The modern trade theory (Helpman and Krugman, 1985) and the new growth theory (Grossman and Helpman, 1991) focus on the above-mentioned dynamic gains from trade and provide a causal chain between exports and economic growth. In the new growth theory, all forms of externalities keep the marginal product of capital from falling, and trade improves long-run growth performance. For a small country, with no trade, there is very little scope for large scale investment in advanced capital equipment, and specialisation is limited by the extent of the market. However, if a poor, small country can trade, there is some prospect of industrialisation and of dispensing with traditional methods of production.

^a The static neoclassical trade theory based on the Ricardian comparative advantage framework assumed perfect competition. In a two-country model, the theory suggested that Portugal should specialise in production of wine while the United Kingdom in textiles in a bilateral trade model. This theory has now lost its relevance as the European Union and common trading blocks have emerged in international trade. Defining each member country of the United Nations by shares of the world output and trade, 175 of 292 member countries are marginal. Prior to the formation of 25 member countries' European Union, USA had dominant shares in the world market (Dutta, 2006). In 2004, (UNCTAD, Handbook of Statistics, 2004) the shares of US exports and imports were 9.12 and 16.50 percent while that of the EU was 40.37 and 38.75 percent, respectively.

Measurement of Liberalisation

Sachs and Warner (1995) constructed a dummy variable for openness based on five individual dummies for specific trade policies. A country was classified as closed if it displayed at least one of the following characteristics: (a) average tariff rates of 40 percent or more (TAR); (b) non-tariff barriers covering 40 percent or more of trade (NTB) (c) a black market exchange rate depreciated by 20 percent or more relative to the official exchange rate on average during the 1970s or the 1980s (BMP); (d) a state monopoly of major exports (XMB) and (e) a socialist economic system (SOC). Table 1 reports data on trade policy for period 1990–1999 and openness is defined as 1, while the state of being not open is given a zero value. Sachs–Warner used this for the decades 1970s and 1980s, and Wacziarg employed the same methodology with some modifications for the classification of open versus closed economies in period 1990–1999. This is presented in Table 1.

There are several possible measures of trade liberalisation or outward orientation, and many investigators (e.g., Leamer, 1988) and organisations (World Bank, 1987) have devised their own measures. Some of the most common are the average import tariff; the average index of non-tariff barriers; an index of the effective rate of protection; an index of relative price distortions or exchange rate misalignment and the average black market exchange rate premium. Most of the African countries are in the moderately and strongly inward oriented categories. When a whole group of countries is relatively inward oriented, it may not be easy to obtain any relationship between the degree of orientation and growth.^b

Brahmbhatt and Dadush (1996) at the IMF have developed an index of openness with four indicators: (a) the ratio of exports and imports to GDP; (b) the ratio of foreign direct investment to GDP; (c) the share of manufactures in total exports and (d) a country's credit rating. A sample of 93 countries is then divided into four groups — fast, moderate, weak and slow integrators. They find that the fast integrators include most of the rapidly growing East Asian exporting economies, while the weakly

^b The World Bank study inappropriately suggested that the economic performance of the outward oriented economies has been broadly superior to that of inward oriented economies in all respects.

Table 1. Data on trade policy.

Country	OPEN90–99 ¹	OPEN90–99 adjusted ²	Avg. tariff (%) ³	Core non-tariff barriers (%) ⁴	Core non-tariff barriers (%) ⁴	All non-tariff barriers (%) ⁵	Black market premium (%) ⁶	Export marketing board ⁷	Socialist ⁷
	1 = open; 0 = closed	1 = open; 0 = closed	1990–1999 (average)	1989–1994 (average)	1995–1998 (average)	1999	1990–1999 (average)		
Albania	1	1	15.9				7.53	0	0
Algeria	0	0	23.97			15.8	177.91	0	0
Angola	0	0					23.62	0	0
Argentina	1	1	12.54	3.1	2.10	67.2	9.30	0	0
Armenia	1	1					0.00	0	0
Australia	1	1	7.91			22.2	0.00	0	0
Austria	1	1	6.91			23.4	0.00	0	0
Azerbaijan	1	1					0.00	0	0
Bangladesh	0	0	43.70	54.2		9.8	83.27	0	0
Barbados	1	1	15.58				2.31	0	0
Belarus	0	0	12.63				n/a	1	0
Belgium	1	1	6.91			23.4	0.00	0	0
Benin	1	0	28.61		1.00		1.93	0	0
Bolivia	1	1	10.34	0.0		16.4	1.49	0	0
Botswana	1	0	20.55				7.82	0	0
Brazil	1	0	17.32	16.5	21.60	44	13.76	0	0
Bulgaria	1	1	17.37				7.44	0	0
Burkina Faso	1	0	29.13				1.98	0	0
Burundi	0	0	7.40				29.55	0	0
Cameroon	1	1	18.43	8.2			1.98	0	0

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Table 1. (Continued).

Country	OPEN90–99 ¹	OPEN90–99 adjusted ²	Avg. tariff (%) ³	Core non-tariff barriers (%) ⁴	Core non-tariff barriers (%) ⁴	All non-tariff barriers (%) ⁵	Black market	Export marketing board ⁷	Socialist ⁷
	1 = open; 0 = closed	1 = open; 0 = closed	1990–1999 (average)	1989–1994 (average)	1995–1998 (average)	1999	1990–1999 (average)		
Canada	1	1	6.81			25	0.00	0	0
Cape Verde	1	0	22.05				0.00	0	0
Central African Republic	0	0	12.80				1.55	1	0
Chad	0	0	15.80				1.98	1	0
Chile	1	1	11.33	5.2	5.20	31.4	9.84	0	0
China	0	0	31.06				35.89	0	1
Colombia	1	1	14.30	55.2	10.30	53.4	8.87	0	0
Congo, Dem. Rep.	0	0	25.47				34.67	1	0
Congo, Rep.	0	0	17.97				1.98	1	0
Costa Rica	1	1	10.60		6.20		5.37	0	0
Cote d'Ivoire	1	0	22.00		30.90		1.98	0	0
Croatia	0	0					37.76	0	0
Cyprus	1	0	10.64		21.60		2.16	0	0
Czech Republic	1	1	6.08				0.22	0	0
Denmark	1	1	6.91			23.4	0.00	0	0
Dominican Republic	1	0	16.70		6.20		16.31	0	0
Ecuador	1	1	11.29			25.8	9.34	0	0

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Table 1. (Continued).

Country	OPEN90-99 ¹	OPEN90-99 adjusted ²	Avg. tariff (%) ³	Core non-tariff barriers (%) ⁴	Core non-tariff barriers (%) ⁴	All non-tariff barriers (%) ⁵	Black market	Export marketing board ⁷	Socialist ⁷
	1 = open; 0 = closed	1 = open; 0 = closed	1990-1999 (average)	1989-1994 (average)	1995-1998 (average)	1999	1990-1999 (average)		
Egypt, Arab Rep.	1	0	30.23	57.3			12.45	0	0
El Salvador	1	0	9.38		5.20		13.59	0	0
Estonia	0	0	1.12				25.09	0	0
Ethiopia	0	0	22.55				111.43	0	0
Finland	1	1	6.91			23.4	0.00	0	0
France	1	1	6.91			23.4	0.00	0	0
Gabon	0	0	19.87				1.98	1	0
Gambia, The	1	1	13.55				4.69	0	0
Georgia	1	1					0.00	0	0
Germany	1	1	6.91			23.4	0.00	0	0
Ghana	1	1	14.93	3.1			2.96	0	0
Greece	1	1	6.91			23.4	1.24	0	0
Guatemala	1	1	10.27				6.03	0	0
Guinea	1	1					3.99	0	0
Guinea-Bissau	1	1					0.00	0	0
Guyana	0	0	13.70				28.23	0	0
Haiti	0	0	10.00				81.12	0	0
Honduras	1	1	8.90				9.21	0	0
Hong Kong, China	1	1		2.1	2.10	0	-0.02	0	0
Hungary	1	1	12.11			21.2	5.40	0	0

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Table 1. (Continued).

Country	OPEN90–99 ¹	OPEN90–99 adjusted ²	Avg. tariff (%) ³	Core non-tariff barriers (%) ⁴	Core non-tariff barriers (%) ⁴	All non-tariff barriers (%) ⁵	Black market	Export marketing board ⁷	Socialist ⁷
	1 = open; 0 = closed	1 = open; 0 = closed	1990–1999 (average)	1989–1994 (average)	1995–1998 (average)	1999	1990–1999 (average)		
Iceland	1	1	3.98			0	1.24	0	0
India	0	0	48.65	99.0	93.80		7.45	0	0
Indonesia	1	0	16.27	53.6	31.30	14	7.10	0	0
Iran, Islamic Rep.	0	0					1199.31	0	0
Iraq	0	0					138,935.90	0	0
Ireland	1	1	3.98			23.4	2.50	0	0
Israel	1	1	7.80				2.09	0	0
Italy	1	1	6.91			23.4	0.00	0	0
Jamaica	1	0	14.68				15.46	0	0
Japan	1	1	5.98			5.7	–0.35	0	0
Jordan	1	1	15.83				3.37	0	0
Kazakhstan	0	0					55.34	0	0
Kenya	1	0	27.47	86.6			15.94	0	0
Korea, Rep.	1	0	11.28	50.0	25.00		0.03	0	0
Kyrgyz Republic	1	1					n/a	0	0
Latvia	1	1	5.73				7.29	0	0
Lesotho	1	1	17.40				3.49	0	0
Liberia	0	0					2306.86	0	0
Lithuania	1	1	4.33				7.45	0	0
Luxembourg	1	1	6.91			23.4	0.38	0	0

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Table 1. (Continued).

Country	OPEN90–99 ¹	OPEN90–99 adjusted ²	Avg. tariff (%) ³	Core non-tariff barriers (%) ⁴	Core non-tariff barriers (%) ⁴	All non-tariff barriers (%) ⁵	Black market	Export marketing board ⁷	Socialist ⁷
	1 = open; 0 = closed	1 = open; 0 = closed	1990–1999 (average)	1989–1994 (average)	1995–1998 (average)	1999	1990–1999 (average)		
Macedonia, FYR	1	0					18.45	0	0
Madagascar	1	1	7.13				5.93	0	0
Malawi	0	0	19.80				28.83	0	0
Malaysia	1	1	11.70	56.3	19.60		1.35	0	0
Mali	1	1	15.66				1.98	0	0
Malta	1	1	7.23				1.20	0	0
Mauritania	1	0	28.23				1.55	0	0
Mauritius	1	0	27.00		16.70		5.25	0	0
Mexico	1	1	12.53	27.8	13.40	50.9	2.24	0	0
Moldova	1	1					0.00	0	0
Morocco	1	0	23.75	58.3	13.40	5.5	3.54	0	0
Mozambique	1	1	16.25				6.87	0	0
Myanmar	0	0	5.70				2280.77	0	0
Nepal	0	0	15.28				24.23	0	0
Netherlands	1	1	6.91			23.4	0.00	0	0
New Zealand	1	1	6.35			34.8	2.50	0	0
Nicaragua	1	1	9.90			5.6	9.98	0	0
Niger	1	1	18.30				1.87	0	0
Nigeria	0	0	29.74	14.4	11.50		151.32	0	0
Norway	1	1	4.87				0.00	0	0

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Table 1. (Continued).

Country	OPEN90–99 ¹	OPEN90–99 adjusted ²	Avg. tariff (%) ³	Core non-tariff barriers (%) ⁴	Core non-tariff barriers (%) ⁴	All non-tariff barriers (%) ⁵	Black market	Export marketing board ⁷	Socialist ⁷
	1 = open; 0 = closed	1 = open; 0 = closed	1990–1999 (average)	1989–1994 (average)	1995–1998 (average)	1999	1990–1999 (average)		
Pakistan	0	0	54.73	17.7			9.74	0	0
Panama	1	1	10.67				0.00	0	0
Papua New Guinea	0	0	16.67				16.57	1	0
Paraguay	1	0	10.91		0.00	22.4	11.83	0	0
Peru	1	1	16.80	6.3		36.8	8.75	0	0
Philippines	1	1	19.09	11.5		14.2	4.36	0	0
Poland	1	1	12.46				2.42	0	0
Portugal	1	1	6.91			23.4	2.04	0	0
Romania	0	0	13.50				104.30	0	0
Russian Federation	0	0	11.24				50979.69	1	0
Rwanda	0	0	38.40				50.78	0	0
Senegal	0	0	13.05	10.3			1.98	1	0
Sierra Leone	0	0	30.25				61.47	0	0
Singapore	1	1	0.32	1.0	2.10	0	0.80	0	0
Slovak Republic	1	1	7.35				5.34	0	0
Slovenia	1	0	10.60				10.06	0	0
Somalia	0	0					246.55	0	0
South Africa	1	1	9.05	36.5	8.30	11.1	3.46	0	0
Spain	1	1	6.91			23.4	1.71	0	0
Sri Lanka	1	0	24.34		22.70		7.84	0	0

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Table 1. (Continued).

Country	OPEN90–99 ¹	OPEN90–99 adjusted ²	Avg. tariff (%) ³	Core non-tariff barriers (%) ⁴	Core non-tariff barriers (%) ⁴	All non-tariff barriers (%) ⁵	Black market	Export marketing board ⁷	Socialist ⁷
	1 = open; 0 = closed	1 = open; 0 = closed	1990–1999 (average)	1989–1994 (average)	1995–1998 (average)	1999	1990–1999 (average)		
Swaziland	1	1	15.10			12.1	7.62	0	0
Sweden	1	1	6.91			23.4	0.00	0	0
Switzerland	1	1	1.38				0.00	0	0
Syrian Arab Republic	0	0	16.00				279.97	0	0
Taiwan, China	1	1	9.85			11.7	0.95	0	0
Tajikistan	1	1					n/a	0	0
Tanzania	0	0	25.12				22.17	0	0
Thailand	1	0	29.54	36.5	17.50		1.80	0	0
Togo	0	0	15.25				1.98	1	0
Trinidad and Tobago	1	0	14.86			0.92	13.22	0	0
Tunisia	1	0	28.25	54.2			3.67	0	0
Turkey	1	1	15.28	5.2	19.80		1.15	0	0
Turkmenistan	0	0					42.86	1	0
Uganda	1	0	14.37		3.10		19.33	0	0
Ukraine	0	0	9.73				9.02	1	0
United Kingdom	1	1	6.91			23.4	0.00	0	0

(Continued)

Table 1. (Continued).

Country	OPEN90–99 ¹	OPEN90–99 adjusted ²	Avg. tariff (%) ³	Core non-tariff barriers (%) ⁴	Core non-tariff barriers (%) ⁴	All non-tariff barriers (%) ⁵	Black market	Export marketing board ⁷	Socialist ⁷
	1 = open; 0 = closed	1 = open; 0 = closed	1990–1999 (average)	1989–1994 (average)	1995–1998 (average)	1999	1990–1999 (average)		
United States	1	1	5.96			29.6	0.00	0	0
Uruguay	1	1	14.00	32.3	0.00	29.3	9.88	0	0
Uzbekistan	0	0					Dual x rt.	0	0
Venezuela	1	1	14.31		17.70	37.3	4.13	0	0
Yemen, Rep.	1	1	20.00				8.34	0	0
Yugoslavia, FR (Serbia/ Montenegro)	0	0					106.44	0	0
Zambia	0	0	18.43		1.00		62.55	0	0
Zimbabwe	0	0	20.43	22.7			132.81	0	0

¹Based on application of Sachs Warner criteria.

²Adjusted dummy based on adjusted criteria: TAR, NTB>20%, BMP>10%. XMB and SOC criteria unchanged.

³Unweighted average tariff, 1990–1999. *Sources:* UNCTAD (2001), World Bank (2000) and WTO (various trade policy reviews).

⁴Core non-tariff barrier frequency on capital good and intermediates includes quotas, licensing, prohibitions and administered pricing. *Source:* Michaelopoulos (1999) and Wacziarg and Welch (2003).

⁵All NTB frequency. All NTBs include core NTBs plus technical measures and automatic licensing. *Source:* UNCTAD (2001).

⁶ $[[\text{parallel Xrate}/\text{official Xrate}] - 1] * 100$. *Source:* Easterly and Sewadeh (2000).

⁷Based on literature reviews.

and slowly integrating group include most of the low-income countries of sub-Saharan Africa and some of the middle-income countries of Latin America. The high performance of Asian countries is the most spectacular economic success linked to exports despite the crisis in East Asia. The economies of Japan, Korea, Taiwan, Singapore, Hong Kong, Malaysia, Indonesia and Thailand have recorded some of the highest GDP growth rates in the world, averaging approximately six percent since 1965 and some of the highest rates of export growth averaging more than 10 percent per annum. Success was not always based on free trade as Japan and Korea followed both export promotion and import substitution at the same time and Government policy remained interventionist. The World Bank study (1993) of the East Asian Miracle highlighted that there is no single East Asian Model and what is important for economic growth is not whether the free market or government intervention rules but is rather a question of getting the economic fundamentals (a high level of physical and human capital) for growth right. Three policies are identified as contributing to the success of the “tiger” economies, namely industrial policies to promote particular sectors of the economy; government control of financial markets to reduce the cost of capital and to direct credit to strategic sectors of the economy and finally policies to promote exports and protect domestic industry. It is indeed necessary that good governance is applied to all the three policies. Trade as such provides externalities and foreign exchange to keep the process of economic growth going.

Winters (2004) concludes that openness to trade boosts economic growth rates in developing countries but not for ever. He claims that when a country opens up by reducing tariffs and removing other barriers, economic growth increases for a period while incomes climb to their new higher level but then settle back to the underlying rate. Open economies seem to have less corruption and lower inflation, and these factors, along with opportunities to sell goods abroad, help growth by stimulating investment. Since openness promotes investment, it is clearly the engine of economic growth. Trade liberalisation and sound finances obviously go together. Dollar and Kraay (2004) have examined the impact of openness which they called “globalisation” and examined its impact on economic growth, poverty and inequality in a large number of developing countries. The first group of globalisers is based on the top one-third of these developing countries in terms of their

growth in trade as a share of GDP at constant prices between 1975–1979 and 1995–1997. These countries are shown in Table 2 and include some well-known economic reformers, namely Malaysia and Thailand in East Asia; China, which has been liberalising trade throughout this period; Bangladesh and India in South Asia with reforms more in the 1990s and several Latin American economies, namely Argentina, Brazil and Mexico. The second group of globalisers is based on absolute declines in average tariff rates. Tariff data are scarce before 1985, and consequently, the reduction in average tariff between the 1985–1989 period and the 1995–1997 period is used, the top one-third of tariff cutters being shown in Table 3. Both Kenya and Pakistan appear here, but neither has shown any upsurge in trade. Six large countries, China, India, Brazil, Thailand, Argentina and Bangladesh, are in both groups. The top one-third of 73 countries in the sample had their share of trade to GDP rise from 16 to 33 percent while tariffs were reduced from 57 to 35 percent (Table 2). Growth in the globalising countries rose from 2.9 percent per annum in the 1970s to 3.1 percent in the 1980s and 5.0 percent in the 1990s. In the non-globalising countries, growth fell from 3.3 percent per annum in the 1970s to 0.8 percent per annum in the 1980s and 1.4 percent in the 1990s.

The Impact of Liberalisation on the Profitability of Enterprises

In Chapters 2 and 3 we analyse the effects of increased trade exposure on the profitability of firms in the Indian industry. While trade reforms are often expected to decrease profit margins as firms struggle to compete in international markets, there is the possibility that increased competition may improve firm efficiency and provide a positive impetus to firm profitability. In this area, this study is different from many others in that it considers both these possibilities. An efficiency index is constructed to directly analyse the impact of changing efficiency levels on firm profit margins. The results of the study indicate that liberalisation has significantly influenced profit margins. However, its main effect is through the impact that it has had on other firm variables — market shares, advertising, research and development and exports, all of which changed after 1991. This implies that the structure of the firm within an industry changes with the trade and other liberalisation measures.

Table 2. Post-1980 globalisers (based on increases in trade volumes).

	Average annual per capita GDP growth (%)						Average trade/GDP (%)						Weighted average tariff rate		
	1970s	1975s	1980s	1985s	1990s	1995s	1970s	1975s	1980s	1985s	1990s	1995s	1985s	1990s	1995s
Argentina	2.3	1.0	-3.2	-2.0	6.8	5.2	11.3	13.2	16.4	15.5	23.7	32.9	27.5	13.9	11.0
Bangladesh	-7.0	3.2	1.2	3.1	3.4	3.7	10.3	11.8	13.8	14.0	18.6	26.7	92.7	54.3	26.0
Brazil	8.8	3.8	-2.9	1.5	0.9	1.6	11.1	10.7	10.3	10.5	13.5	17.9	45.8	21.0	11.5
China	1.4	3.4	3.9	1.7	8.6	7.8	12.5	14.1	26.7	28.5	30.1	34.2	38.8	39.9	20.9
Colombia	4.0	3.5	0.0	2.5	2.4	0.6	33.8	30.9	33.4	33.1	45.0	58.9	29.4	16.6	12.2
Costa rica	3.4	3.6	-3.6	2.0	2.0	-0.1	74.5	77.1	71.3	82.0	108.3	128.1	19.5	12.6	11.2
Dominican Rep.	7.6	1.7	-2.1	3.5	1.8	5.6	38.7	31.5	41.3	40.3	56.3	92.3	—	17.8	16.2
Haiti	1.4	3.4	-3.4	-2.2	-7.3	-0.3	32.2	43.0	47.7	50.8	67.0	98.9	11.6	—	10.0
Hungary	5.9	2.8	1.2	1.4	-2.8	3.3	40.9	47.1	48.4	52.7	57.6	74.0	18.0	9.9	14.8
India	-1.2	0.7	3.3	4.1	2.6	4.4	12.7	13.7	15.9	16.3	17.0	22.1	99.4	61.9	38.3
Ivory coast	1.6	5.1	-3.8	-3.6	-3.4	3.3	54.4	52.7	70.4	67.5	68.0	76.4	26.3	23.8	20.7
Jamaica	2.5	-3.8	-0.1	3.4	-0.8	-2.7	80.0	75.9	76.5	106.6	109.2	125.9	18.4	19.6	10.9
Jordan	8.2	10.8	1.1	-4.3	1.4	-1.6	—	94.2	118.2	104.0	162.2	166.2	16.3	15.8	16.0
Malaysia	6.5	6.6	3.8	3.0	5.8	5.4	89.3	91.7	106.8	120.8	173.9	219.8	14.9	14.3	8.9
Mali	0.8	4.5	-1.3	1.1	-1.8	2.3	28.6	29.9	42.8	51.3	51.6	51.3	—	—	18.8
Mexico	4.5	3.3	-2.3	-0.2	2.4	4.2	17.0	17.7	21.2	23.2	33.5	49.9	16.7	12.8	12.8
Nepal	0.7	11.0	1.0	2.0	3.0	2.2	16.5	25.4	31.0	32.2	42.0	60.3	21.8	16.1	11.0
Nicaragua	2.7	-9.8	0.5	-7.5	-2.2	—	49.1	52.9	65.6	51.0	68.5	85.1	22.1	12.7	10.7
Paraguay	3.7	5.2	-4.2	-0.7	1.0	-0.2	28.2	32.1	32.0	37.8	77.3	99.4	10.9	13.1	9.3
Philippines	3.1	3.3	-3.1	2.9	-0.6	3.1	40.5	41.6	52.2	56.2	75.5	106.1	27.8	24.5	17.2
Rwanda	-0.9	2.8	0.4	-1.5	-14.9	0.3	19.1	22.9	26.4	29.5	46.5	37.4	33.0	38.4	—
Thailand	1.8	6.2	3.0	6.9	6.0	1.5	47.4	47.1	49.8	59.1	84.6	94.6	41.0	36.6	23.1
Uruguay	0.1	2.8	-6.3	4.1	4.9	4.3	35.5	42.6	47.3	50.0	66.4	84.3	33.7	18.9	9.6
Zimbabwe	5.8	-3.1	0.0	-0.9	0.4	3.1	—	43.8	44.2	44.8	59.4	77.1	9.2	17.2	21.5

Source: Dollar and Kraay (2004).

Table 3. Post-1980 globalisers (based on reductions in tariffs).

Country	Average annual per capita GDP growth (%)						Average trade/GDP (%)						Weighted average tariff rate		
	1970s	1975s	1980s	1985s	1990s	1995s	1970s	1975s	1980s	1985s	1990s	1995s	1985s	1990s	1995s
Argentina	2.3	1.0	-3.2	-2.0	6.8	5.2	11.3	13.2	16.4	15.5	23.7	32.9	27.5	13.9	11.0
Bangladesh	-7.0	3.2	1.2	3.1	3.4	3.7	10.3	11.8	13.8	14.0	18.6	26.7	92.7	54.3	26.0
Benin	-0.2	0.1	-1.9	-4.6	1.4	2.6	78.7	87.2	88.7	63.9	51.8	45.8	42.8	41.0	12.7
Brazil	8.8	3.8	-2.9	1.5	0.9	1.6	11.1	10.7	10.3	10.5	13.5	17.9	45.8	21.0	11.5
Burkina Faso	1.2	2.6	0.9	1.2	-0.9	3.2	42.4	48.1	48.5	46.1	43.1	37.9	60.8	—	28.5
Cameroon	2.9	5.5	4.0	-2.2	-7.2	2.1	53.6	46.7	59.3	61.3	68.5	65.0	32.0	18.6	18.1
Central Afr. R	-0.9	0.9	-3.2	-1.9	-2.8	-0.2	40.7	43.1	48.1	44.3	46.9	42.1	32.0	—	18.6
China	1.4	3.4	3.9	1.7	8.6	7.8	12.5	14.1	26.7	28.5	30.1	34.2	38.8	39.9	20.9
Colombia	4.0	-3.5	0.0	2.5	2.4	0.6	33.8	30.9	33.4	33.1	45.0	58.9	29.4	16.6	12.2
Dominica	—	—	5.7	5.9	1.4	1.8	—	109.6	108.9	114.5	118.5	112.3	31.9	28.0	15.0
Ecuador	8.3	4.0	-2.8	-1.1	1.1	0.6	49.8	54.9	46.9	47.0	52.5	57.5	34.3	10.6	11.7
Egypt	0.3	4.1	3.7	-0.6	0.1	3.3	84.0	98.7	83.6	64.6	61.6	59.7	39.7	35.3	28.1
Ethiopia	0.3	0.8	-0.3	1.9	-1.2	5.0	—	—	27.7	28.6	22.9	25.4	29.6	28.8	16.3
India	-1.2	0.7	3.3	4.1	2.6	4.4	12.7	13.7	15.9	16.3	17.0	22.1	99.4	61.9	38.3
Indonesia	5.5	5.6	5.7	2.5	4.3	4.5	58.0	69.4	60.1	48.6	50.2	57.0	27.9	20.1	13.2
Kenya	9.2	2.7	-2.2	3.5	-0.6	0.6	109.5	79.9	56.6	51.4	60.7	78.2	39.4	33.3	13.5
Nicaragua	2.7	-9.8	0.5	-7.5	-2.2	—	49.1	52.9	65.6	51.0	68.5	85.1	22.1	12.7	10.7
Pakistan	-2.4	3.3	2.1	2.5	0.8	-0.3	47.6	37.1	35.7	33.4	34.9	34.5	69.2	59.8	41.7
Peru	3.4	-3.1	-2.8	-3.3	2.7	3.0	47.0	43.7	45.3	37.8	44.3	52.7	45.0	19.0	13.3
Thailand	1.8	6.2	3.0	6.9	6.0	1.5	47.4	47.1	49.8	59.1	84.6	94.6	41.0	36.6	23.1
Uganda	-0.8	-1.9	1.9	0.4	1.6	4.2	—	—	35.3	37.8	31.4	43.1	25.0	17.1	13.0
Uruguay	0.1	2.8	-6.3	4.1	4.9	4.3	35.5	42.6	47.3	50.0	66.4	84.3	33.7	18.9	9.6
Venezuela	-1.1	2.2	-3.7	-1.3	2.3	0.2	61.4	51.5	42.6	42.8	47.2	54.7	31.1	15.8	12.7
Zambia	2.0	-6.9	-4.0	-1.7	-1.4	2.4	194.2	145.8	98.3	87.6	78.9	78.3	29.9	26.4	17.0

Source: Dollar and Kraay (2004).

As mentioned in the previous paragraph, the determinants of firm-level profit margins are analysed in the Indian manufacturing sector in this chapter. The model we estimate is rich in its dynamic characterisation allowing as it does for lagged terms, trend movements, business cycle effects and a structural break in 1991. We hypothesise that the reforms undertaken by the government in 1991 constitute a structural break that influences a firm's independence to react to other firms as well the extent of competition faced by these firms. Inserting this into the standard industrial organisation model of profits, a dynamic market model is obtained. Estimating this model for the 1980–1998 period, it was found that the 1991 reforms did have a significant impact on profit margins in the Indian industry. The reforms have worked through their impact on firms' behavioural variables — advertising, research and development, capital-output ratios and managerial remuneration — though the precise variables that were significant varied from sector to sector. We find that relatively inefficient firms make significantly lower profits than others both before and after the liberalisation, as one would expect.

The Impact of Liberalisation on Exports and Imports in China and India

In Chapter 4, we turn our attention to exports at a country level for the Chinese economy. Trade liberalisation may indeed play a direct role in encouraging export growth, and in China, performance was closely associated with trade promotions, and liberalisation schemes, both regional and national. The relationship between exports and economic growth is strong in developing economies. Both the externality effects of exports on the non-exports sector and the higher marginal productivity of the exports sector relative to the non-exports sector play an important role in promoting exports and the GDP growth. The underlying theoretical model of Feder (1982) is used with the data of the Chinese provinces, and it is shown that the economic structure, degree of openness and policy environment have a significant role in the relationship between exports, and economic growth. Coastal regions in China have shown a tremendous improvement in exports, and export processing zones have led to both the growth in exports and the growth in domestic output at an unprecedented rate in these regions of China.

As exports are stimulated with export promotion policy and liberalisation, the removal and relaxation of tariff and non-tariff barriers can improve the performance of imports and import price elasticities. In Chapter 5, we examine the impact of liberalisation on the price elasticities of imports at a commodity level for broad commodity groups and at an aggregate level for the Indian economy over period 1993–1997. Liberalisation is implemented by reducing tariff and non-tariff barriers and relaxing exchange controls. The impact of tariffs and a market-based exchange rate is introduced in the import price of the commodity. Relative price (import/domestic) elasticities for each commodity group are estimated using panel data for six countries over five years. For the Indian economy, relative price elasticities for each of the years at an aggregate level are obtained using data for 20 commodity groups as observations, and these show that the price elasticity tends to rise with the increase in liberalisation when tariff rates are reduced.

Liberalisation, Growth Rates and Terms of Trade

Chapter 6 examines whether trade and/or financial liberalisation results in the acceleration or deceleration of convergence of per capita real incomes in Africa, Asia and Latin America. Do countries that have low per capita income experience higher economic growth after liberalisation as compared with pre-liberalisation? Data for 14 Asian countries, 30 African countries and 20 Latin American countries are available, some of which did not liberalise during period 1970–1999. The panel data methodology and the concepts of beta-convergence and sigma convergence are used for each of the regions. The study concludes that liberalisation has accelerated convergence in real per capita incomes to their regional income levels for Asian and Latin American economies, while for African countries, liberalisation seems to have produced a divergence of real per capita incomes from their mean level. This suggests that in Africa conditions are probably not right for achieving higher economic growth despite some liberalisation attempts.

Terms of trade play a very important role in enhancing trade. Primary producing countries have faced unfavourable terms of trade for a long period of time. In Chapter 7, we, therefore, examine the relationship between the terms of trade and trade balance to GDP ratios for a large number of developing economies using data on the barter terms of trade, real exchange

rate and trade balances. The literature on the subject postulates a J-curve or S-curve^c between the terms of trade and trade balance, and we examine whether there is any evidence of a J-curve or S-curve relationship in time series data over period 1970–1999. We find that for a few economies in Asia, Africa and Latin America, the existence of an S-curve is supported. However, for a large number of countries, neither a strict J-curve nor an S-curve relationship holds.

Liberalisation, Growth and Trade Balance

In Chapter 8, we study the relationship between liberalisation and economic growth for as many developing countries as possible over three decades. This is a study of 42 developing countries of Asia, Africa and Latin America in which we first examine the impact of trade liberalisation on economic growth, the investment share of GDP, openness, the trade balance and current account (as a percentage of GDP). Both panel data and country-by-country data are used to measure the impact of liberalisation on domestic economic growth measured in PPP terms from the data available in the Summers *et al.* (2001) study. Domestic economic growth is often positively related to liberalisation for many countries in our sample. Next we analyse the impact of growth on the trade balance and current account to examine whether higher economic growth due to liberalisation leads to an adverse effect on the balance of trade. Trade balance is normalised by GDP to take into account different country sizes. We also allow control variables in both sets of regressions such as the terms of trade, advanced countries' growth rates, liberalisation and debt related variables. This is studied rigorously in the next chapter.

The balance of payments constrained growth model uses a foreign exchange constraint that limits growth, and using the Harrod multiplier, Thirlwall and Hussain (1982) derived a growth equation, which is

^c Depreciation of exchange rate causes the trade deficit to widen initially and then to narrow after some delay. This is known as the J-curve effect since a graph of trade surplus will resemble a J if this happens. An S-curve is a slight extension of the J-curve in the sense that the impact of exchange rate depreciation wears out after a while and there is no further improvement when all impacts are realized. Hence, at the top of the curve, the slope is zero or negative.

apparently constrained by the balance of payments. We use this model in the first part as a behavioural equation and establish that liberalisation promotes growth, with output growth in the pre-liberalisation period lower than that in the post-liberalisation period. With panel data for 42 countries, an analysis is conducted on the relationship between growth and liberalisation using regional panels for three regions (fixed effect and random effect models) and country-by-country (OLS regression) data. These relationships suggest that liberalisation promotes growth but growth itself may have negative effect on the trade balance for a large majority of countries.

Liberalisation can affect trade balance adversely in the short run as some evidence shows from the previous chapter. Hence, we study the impact of liberalisation on growth and trade deficits and current accounts of developing countries in Chapter 9. It is expected that trade liberalisation would promote economic growth from the supply side by leading to a more efficient use of resources, by encouraging competition and by increasing the flow of ideas and knowledge across national boundaries. Trade liberalisation could lead to faster import growth than export growth, and hence the supply side benefits may be offset by the unsustainable balance of the payment position. This study uses panel data for 42 countries (both time-series and cross-section dimension) to estimate the effect of trade liberalisation on growth and growth on trade balance while controlling for other factors such as income terms of trade. The major finding of the study is that trade liberalisation promotes growth in most countries, but the growth itself has a negative impact on the trade balance. Countries following trade liberalisation could have high real exchange rates, a worsening savings-investment balance and consequently a worsening current account and trade balance. This chapter uses the dynamic stochastic model of current account in which the principle of consumption smoothing is applied to rational forward-looking agents acting under inter-temporal budget constraints.

One of the models in a cross-section regression study makes use of political and security variables and concludes that the convergence or “catching-up” hypothesis is supported and extreme political repression tends to constrain growth. One unit change in the liberalisation index leads, on average, to a 1.62 percentage point change in growth rates, *ceteris paribus*.

Financial Instability and Volatility

So far, we have looked at the impact of trade liberalisation. In the last chapter (Chapter 10), financial liberalisation and its instability are examined. The study aims to examine the instability and volatility of various components of capital inflows/outflows to developing economies. It is indeed the case that both instability and volatility in these areas have increased during period 1990–1998 in relation to previous decades. Contagion and herd behaviours among private investors have contributed to financial instability and crises. International coordination of official financial and development assistance among donor countries and multilateral agencies may help to decrease the probability of future financial crises.

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